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Hon. Mary Jo Heston
Chapter 11
Telephonic Hearing
Hearing Date: 4/4/18
Hearing Time: 9:30 a.m.
Response Date: 3/28/18

Attorneys for Hampton Heights, LLC

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON

In re

PAUL JOE,

Debtors.

Case No. 17-41216-MJH

HAMPTON HEIGHTS, LLC'S
OBJECTION TO CONFIRMATION OF
DEBTOR'S SECOND AMENDED PLAN
OF REORGANIZATION DATED
FEBRUARY 14, 2018

Hampton Heights, LLC ("Hampton Heights"), the Class 2 secured creditor in this single-asset real estate case, sets forth the following objection to confirmation of the Debtor's Second Amended Plan of Reorganization dated February 14, 2018 (the "Plan," Doc. No. 75):

RELEVANT BACKGROUND FACTS

Hampton Heights' secured claim against the Debtor dates back to June 17, 2010 under the terms of a promissory note with an original principal amount of \$1,100,000 and just an 18-month term (the "Original Note"). The Original Note required interest-only payments of \$10,100 per month and an interest rate of 11% per annum. The Debtor defaulted under the terms of the Original Note, and in March 2012 Hampton Heights commenced nonjudicial foreclosure proceedings. On the morning of the sale date, August 17, 2012, the Debtor filed a Chapter 11 bankruptcy in the U.S. Bankruptcy Court for the District of Oregon (In re Paul Joe, Case 12-36345-elpl1, District of Oregon, the "Prior Case") to stop the foreclosure sale.

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1 After significant negotiation and litigation, a Chapter 11 plan was confirmed in the Prior
2 Case on April 29, 2013 (the “2013 Plan”). Among other things, the 2013 Plan provided for
3 refinancing of the Original Note with a new promissory note dated July 1, 2013, in the original
4 principal amount of \$1,243,583.31 and set to mature on July 1, 2016 (as defined in the 2013
5 Plan, the “Reorganization Note”).

6 The Reorganization Note forms the basis of Hampton Heights’ secured claim in the
7 current case and is attached to Hampton Heights’ Proof of Claim (Claim 5). Under the terms of
8 the Reorganization Note, the Debtor now owes not less than \$1,590,071.60 as set forth in
9 Hampton Heights’ Proof of Claim. The debt owed to Hampton Heights has only continued to
10 grow since it originated in 2010 and will continue to grow under the proposed Plan.

11 The Debtor has not made a regular payment to Hampton Heights on its secured claim since April
12 2016, and the loan is fully mature. The Plan seeks to effectively extend what was originally an
13 18-month loan running from June 17, 2010, into an almost 13-year loan that would not mature
14 until January 1, 2023, if the Plan is confirmed.

15 SUMMARY OF OBJECTION

16 The Debtor’s Plan is not confirmable for the following reasons:

- 17 (1) The Plan does not comply with 11 U.S.C. 1129(a) because it is not proposed in
18 good faith, will result in diminution of the Debtor’s estate and is therefore not in
19 the best interests of unsecured creditors, and is likely to be followed by
20 liquidation and is therefore not feasible;
- 21 (2) Hampton Heights will not receive fair and equitable treatment as required under
22 11 U.S.C. (b)(2)(a), on account of (i) the Debtor’s repeated bankruptcy filings and
23 other efforts resulting in a *de facto* extension of an 18-month short-term loan into
24 an approximately 13-year loan, (ii) the Debtor’s impairment of Hampton Heights’
25 claim despite insisting that Hampton Heights is significantly over-secured, and
26 (iii) the Debtor’s apparent intent to sell a portion of Hampton Heights’ real

property collateral without paying Hampton Heights' claim in full and without even Hampton Heights' consent;

(3) The Plan is an impermissible modification of the confirmed 2013 Plan (therefore constituting a so-called "Chapter 22 bankruptcy"), and is not justified by any extraordinary and unforeseen circumstances that impaired the Debtor's ability to comply with the confirmed 2013 Plan; the Plan therefore violates 11 U.S.C. 1127(b) (Modification of Plan), and cannot comply with the Bankruptcy Code's requirement of good faith;

(4) The Debtor's Plan is internally inconsistent in that it simultaneously seeks to extend secured debt for an additional five years (through January 1, 2023) but also intends to effectuate a liquidation. The Debtor's plan to partition the property in connection with a partial sale and refinance transaction is wholly speculative and violates the Hampton Heights Trust Deed. The Debtor has not offered any evidence of the property's current value, and has not provided any preliminary plans or conditional approvals to show that a partition of the property is realistic or even plausible. The Debtor's lack of diligence with respect to a sale or refinance of the property, combined with his repeated failure to make debt service payments, real property tax payments, and certain utility payments indicate that liquidation is inevitable, even if the Debtor portrays it is merely optional; and

(5) The Debtor's apparent intent to "sell all or a portion" of Hampton Heights' real property collateral under Section 7.4 of the Plan without Hampton Heights' consent violates the Trust Deed, as well as the general requirements and protections of 11 U.S.C. 363 and Bankruptcy Code. It is manifestly unreasonable for the Plan to essentially pre-approve *any* proposed sale of Hampton Heights' collateral so long as the Debtor enters the contract for sale "on or before March 1, 2021." Because the sale contemplated by the Plan is so speculative (if not wholly

hypothetical), and because the Plan contains no details or constraints to protect the rights of secured creditors, the Debtor must be required to either (1) obtain Hampton Heights' consent prior to any sale of the property, or (2) obtain approval from this Court, after notice and a hearing, with respect to any proposed sale of the collateral.

DISCUSSION

Hampton Heights therefore submits the following points in support of this objection to the Debtor's proposed Plan:

1. The Plan misstates the current amount of Hampton Heights' secured claim and the non-default rate of interest under the Reorganization Note. As of December 31, 2017, the balance owing to Hampton Heights and secured by the Debtor's property was not less than \$1,590,071.60, consisting of \$1,243,583 in principal and \$346,488.29 in accrued but unpaid interest, together with presently accruing interest at the non-default rate of 10% per annum, legal fees and other costs. See Claim 5, Exhibits 1-4. The Debtor's First Amended Disclosure Statement dated February 1, 2018, states on page 8 that he will pay interest at the "non-default rate," but also that "the debt will accrue interest at 7%." See Doc. 72, p. 8 (subsections (a) and (c)). The same confusion appears in the plan of reorganization. See Doc. 72, p. 23. Notwithstanding this inconsistency, Hampton Heights is entitled to receive the non-default rate of 10% interest under the terms of the 2013 Plan as memorialized by the Reorganization Note.

2. The Plan depends almost entirely on an increase in rent that the tenant cannot pay. For this reason alone, the Plan is not feasible. In the Debtor's Prior Case, he reported rental income of \$10,100/month from the property. (Prior Case, Doc. 14, Statement of Current Monthly Income, filed August 29, 2012). Under the 2013 Plan, the rent was to increase to \$11,375/month as of January 2013. Instead of going up, the Debtor's rental income has gone down. The tenant's current rent is \$7,254.24. Doc. 72, p. 26. This is approximately

1 \$4,000/month *lower* than expected under the 2013 Plan. Even so, the tenant is currently in
2 arrears in the amount of \$17,500. Doc. 72, p. 26.

3 3. Like the 2013 Plan, the current Plan suggests that the tenant will agree to and be
4 able to pay a significant rent increase (from \$7,254.24 to \$10,500), while simultaneously curing
5 the \$17,500 arrearage and paying all property taxes. Doc. 72, p. 26. With the tenant already in
6 default at a substantially lower rate, it is unreasonable to presume that the tenant will be able to
7 finance the Plan by paying substantially higher rent, curing existing arrearages, and paying
8 substantially delinquent property taxes.

9 4. The proposed lease (Doc. 75, p. 18) requires the tenant to pay the property taxes
10 and keep them current. Hampton Heights believes that the existing lease has the same
11 requirement. If the tenant could afford to pay the property taxes, which are a little more than
12 \$1000/month, then the property taxes would be current. The property taxes are seriously
13 delinquent, which means that the tenant cannot afford to pay the property taxes. The taxes for
14 2017-18 are unpaid (\$13,193.34 due as of February 15, 2018). The taxes for 2016-17 are unpaid
15 (\$14,910.12 due as of February 15, 2018). One installment of the taxes for 2015-16 is still
16 unpaid (\$5,301.73 as of February 15, 2018). The total delinquency is \$33,405.19. If the tenant
17 cannot afford to pay the property taxes, then the tenant can't afford to pay the increased rent on
18 which the Plan depends for its success.

19 5. The Plan may seek to impair the claim of Hampton Heights by reducing the
20 interest rate to 7% from the non-default rate of 10% confirmed in the 2013 Plan, which itself is a
21 reduction from the Original Note rate of 11% (See Prior Case, Doc. 102, p. 8 (Exhibit A)). The
22 Debtor was unable to pay off that loan when it matured in 2011. The Debtor was unable to pay
23 off the restructured loan when it matured on July 1, 2016. The Debtor has provided no basis for
24 this Court to conclude that he will be able to make payments under the Plan or pay off the loan
25 when it matures under the terms of the Plan in 2023.

1 6. The Debtor's lack of diligence suggests both that the Plan is not feasible and is
2 not proposed in good faith. If the real property is truly worth \$2,500,000 as the Debtor insists,
3 sufficient time has passed for the Debtor to have obtained a credible valuation and financing
4 based on that valuation—in such case, the Debtor has simply failed to take necessary action. If
5 the real property is not worth \$2,500,000, the Debtor has proposed the Plan simply to stall an
6 inevitable foreclosure and collect rent while the case is pending. The Debtor has had nearly
7 eight years to sell the property and pay off the Hampton Heights loan but has taken no
8 discernable steps toward a sale. Hampton Heights agrees with the argument of the City of St.
9 Helens that the Debtor has not diligently pursued his plan to partition and sell a portion of the
10 property (Creditor City of St. Helens' Reply to Debtor's Opposition, Doc. 58.), and also that the
11 partition faces significant legal hurdles and obstacles to marketability (Creditor City of St.
12 Helens' Objection to Confirmation of Chapter 11 Plan, Doc. 80, p. 3-4. The Debtor's conduct
13 demonstrates therefore that the Plan is not feasible, has been proposed in bad faith, or both.

14 7. The Plan asserts that the value of the Debtor's real estate is \$2,500,000 (Doc. 53,
15 p. 47), but offers no evidence in support of the Debtor's assertion. In the Debtor's prior
16 bankruptcy, Hampton Heights obtained an appraisal that valued the property at \$1,300,000 as of
17 March 12, 2013 (Prior Case, Doc. 102, p. 29 (Exhibit E)). A broker's opinion of value in
18 December 2012 valued the property at \$850,000 to \$875,000. (Prior Case, Doc. 102, p. 13
19 (Exhibit C)). The Debtor asserts without evidence that the property is now worth nearly twice as
20 much as it was worth five years ago, even though it does not produce enough income to service
21 its debt or pay the property taxes. Notwithstanding, if the Debtor's valuation is remotely
22 accurate, he does not need five years to complete a sale and refinance transaction—rather, the
23 Plan should be limited to a one-year term, compelling the Debtor to diligently pursue a
24 successful partition and sale in a timely manner, subject to secured creditor approval.

25 8. The secured claims against the Debtor's property will only continue to grow and
26 thereby decrease the amount that will be available to unsecured creditors in what appears to be

an inevitable liquidation. Since 2011, the amount of Hampton Heights Claim as compared to the value of the collateral has increased as follows:

	Principal or Recapitalized Balance	Increase in Principal Balance	Maturity Date	Estimated Value of Collateral	Evidentiary Basis for Estimate
Original Note	\$1,100,000.00	n/a	12/01/11	n/a	n/a
Reorganization Note	\$1,243,583.31	\$143,583.31	06/30/15	\$1,300,000	Appraisal (J.J. DeVoe Appraisal dated March 28, 2013 filed in Prior Case, Doc. 102, p. 30).
Plan Treatment	\$1,590,071.60	\$346,488.29	01/01/23	\$2,500,000	None (See First Amended Disclosure Statement, Doc. 72, Ex. B, p. 1).

Given that the Plan calls for monthly payments of \$7,500, but also that interest will accrue at the non-default rate (10% per annum or \$13,250 per month), the secured claim of Hampton Heights will increase by at least \$5,750.60 per month (\$69,007 per year) until the loan matures in 2023. The Debtor's equity in the property, if any, will be consistently diminished even if he makes all payments to Hampton Heights under the Plan. The Debtor has not demonstrated any ability to make regular monthly payments to Hampton Heights or his other creditors in the eight years that this loan has been pending. The circumstances of this case overwhelmingly suggest that the Debtor will not be able to comply with the Plan, and that confirmation of the Plan will inevitably be followed by a liquidation or third Chapter 11 filing in which Hampton Heights' secured claim will only have increased.

9. Even if the Debtor's rental income could support the proposed payments to Hampton Heights and other creditors under the Plan, the Debtor will not have the capacity to pay known and unknown post-petition obligations such as the sewer charges payable to the City of

1 St. Helens, real property taxes, insurance, building maintenance, or administrative costs. The
2 Debtor has fallen behind on these obligations while this case has been pending even without the
3 obligation to make full debt service payments. This alone calls into question the Debtor's ability
4 to perform under the Plan.

5 10. The totality of the circumstances demonstrate that the Plan has not been proposed
6 in good faith as required by 11 U.S.C. 1129(a)(3).¹ The Debtor's lack of diligence, lack of
7 candor at the commencement to the case, and repeat Chapter 11 filings demonstrate a lack of
8 good faith. Though serial Chapter 11 filings are not *per se* impermissible or *per se* made in bad
9 faith, a second Chapter 11 plan may modify a previous confirmed plan only "where there are
10 extraordinary circumstances that are unforeseeable." *PNC Mortg. v. Deed & Note Traders, LLC*
11 (*In re Deed & Note Traders, LLC*), 2012 Bankr. LEXIS 1513, at *20 (B.A.P. 9th Cir. Apr. 5,
12 2012). Indeed, "even extraordinary and unforeseeable changes will not support a new Chapter
13 11, if these changes do not substantially impair the debtor's performance under the confirmed
14 plan." *Caviata Attached Homes, LLC v. U.S. Bank, N.A. (In re Caviata Attached Homes, LLC)*,
15 481 B.R. 34, 46-47 (B.A.P. 9th Cir. 2012) (emphasis added). The 2013 Plan, as memorialized
16 by the Reorganization Note, required payment of Hampton Heights' claim on or before July 1,
17 2016, with interest accruing at 10% per annum. The Debtor's current Plan seeks to modify this
18 maturity date to January 1, 2023, and (depending on one's interpretation of the inconsistency
19 noted in Section 1 of this Objection) adjust the interest rate downward to 7% from the non-
20 default rate of 10%. This substantial extension of the maturity date approved in the Prior Case
21 and reduction of the non-default interest rate set forth in the Reorganization Note is an
22 impermissible modification of the 2013 Plan. The Debtor has not experienced any extraordinary
23 and unforeseen circumstances that impaired the Debtor's ability to comply with the confirmed
24 and substantially consummated 2013 Plan. In fact, that Debtor's circumstances with respect to

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26 ¹

1 Hampton Heights and the collateral property are eerily similar. As with the Prior Case, the
2 collateral property simply has not generated enough income to satisfy the Debtor's debt
3 obligations and costs, and the Debtor has not diligently pursued known alternatives to a second
4 bankruptcy filing. The Debtor only began working to generate personal income in January 2018
5 despite his crumbling financial condition and pendency of this case, and only hired a Realtor in
6 January 2018 in an apparent effort to show this Court and anxious creditors some progress. The
7 Debtor's historic lack of diligence contradicts any assertion by the Debtor that the Plan has been
8 proposed in good faith, or that extraordinary circumstance prevented him from complying with
9 the 2013 Plan.

10 11. The Debtor's proposal to sell all or a portion of the collateral property as outlined
11 in Section 7.4 of the Plan impermissibly violates Hampton Heights' Trust Deed and rights as a
12 secured creditor under 11 U.S.C. 363. Doc. 75, p. 7. Hampton Heights' Trust Deed provides
13 that "Should the grantor either agree to, attempt to, or actually sell, convey or assign all (or any
14 part of the property... without first obtaining the written consent or approval of the beneficiary,
15 then... all obligations secured by this [Trust Deed]... shall become immediately due and
16 payable." See Claim 5, Ex. 3. Hampton Heights is therefore entitled to full payment of its claim
17 upon any sale of any portion of its real property collateral, and no such sale may occur without
18 Hampton Heights' express consent or full payment of its lien. The Debtor has not and cannot
19 provide any specific details with respect to such a sale, and there are no constraints on such a
20 sale set forth in Section 7.4 of the Plan. The Debtor has made no effort whatsoever to obtain an
21 objective valuation of the Property, or provided any assurance that a portion of the property will
22 not be sold at the expense and diminution of the total value of the collateral. Therefore, the
23 Debtor must be required to either (1) obtain Hampton Heights' consent prior to any sale of the
24 property, or (2) obtain approval from this Court, after notice and a hearing, with respect to any
25 proposed sale of the collateral.

1 goal during the Prior Case or during the—does not constitute fair and equitable treatment of
2 Hampton Heights’ secured claim.

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4 DATED: March 28, 2018

KELL, ALTERMAN & RUNSTEIN, L.L.P.

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14 Attorneys for Hampton Heights, LLC

1 **CERTIFICATE OF SERVICE**

2 I hereby certify that on the date shown below, I served a true and correct copy of the
3 foregoing HAMPTON HEIGHTS, LLC'S OBJECTION TO CONFIRMATION OF DEBTOR'S
SECOND AMENDED PLAN OF REORGANIZATION DATED FEBRUARY 14, 2018 on:

4 All ECF Participants

5 Douglas P Cushing on behalf of Creditor City of St. Helens
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13 by electronic transmission.

14 DATED: March 28, 2018

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CERTIFICATE OF SERVICE

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